

Moscow Financial Weekly

For the week ending January 31, 2003
Treasury Attache's office, U.S. Embassy Moscow

Highlights

- CBR diversifies forex reserves
- VEB to return Roseximbank shares to government

Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	R31.8345	0.10	0.16
Monetary Base*	R894.3 bln	-1.70	-4.90**
CPI	NA	NA	2
International Reserves*	\$48.2 bln	0.21	1.05
RTS Index (end of week)	345.56	0.66	-3.76%
Refinancing rate	23	0	4

*For week prior

** % chg from the abnormally high seasonal level at the end of the year.

Economic Developments

According to Finance Minister Aleksei Kudrin, the Finance Ministry sees no need to issue **Eurobonds** this year. Last year, the Ministry didn't issue any Eurobonds, even though the state budget had allocated up to \$2 billion for them. This year's budget stipulates a total possible issuance of \$1.25 billion. According to the Minister, currently there are no troubles with budget revenue collection, and the financial reserve of more than R200 billion guarantees the payments of external debt obligations for at least six months. The decision to wait with any Eurobond issuance is quite understandable: as Russia approaches investment-grade rating and pays its debt on time, new borrowing will ostensibly become less expensive.

According to Deputy Prime Minister and Finance Minister Alexey Kudrin, by February 15 the Finance Ministry will submit to the GOR its proposal to establish a **stabilization fund**, the purpose of which will be to protect the budget from a possible deterioration in market conditions. Kudrin said that the fund would be formed using the budget surplus and special remittances of a portion of taxes collected from the commodity sector during periods of favorable market conditions. A special clause on establishing the fund should be incorporated into the Budget Code, he said. The establishment of such a fund should not have any material impact as the government has been using a financial reserve for the virtually the same purpose, but formal establishment of a fund could provide more transparency than exists currently, as well serving as an additional tool to manage the exchange rate.

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Banking sector

The CBR said in a press-release that it had purchased other foreign currencies with U.S. dollars in 2002, for the sake of diversification of the **foreign exchange reserves** structure. At the beginning of 2002, currency reserves (not including gold) consisted almost completely of dollars and euros, with the share of euros not exceeding 10%. By the end of the year the share of euros more than doubled and the shares of other currencies also increased. The share of dollars declined from nearly 90% to less than 75%. This should help match exchange reserves to foreign debt payments (a third of which are in euros) and maintain value of the reserves.

Deputy Prime Minister and Finance Minister Alexey Kudrin stated at a meeting of the Union of Industrialists and Entrepreneurs that the GOR would adhere to the policy of **moderate real appreciation of the ruble**, limited to 3-4% a year, "but not more, as was the case in 1999 and 2000." Kudrin explained that such real rate dynamics would allow Russian enterprises to go through modernization purchasing imported equipment at affordable prices. According to the CBR, the ruble appreciated 5.8% in 2002 in real terms against the dollar, but weakened 6.9% against the Euro. The effective rate of the ruble against a trade-weighted basket of currencies went up 2.9%.

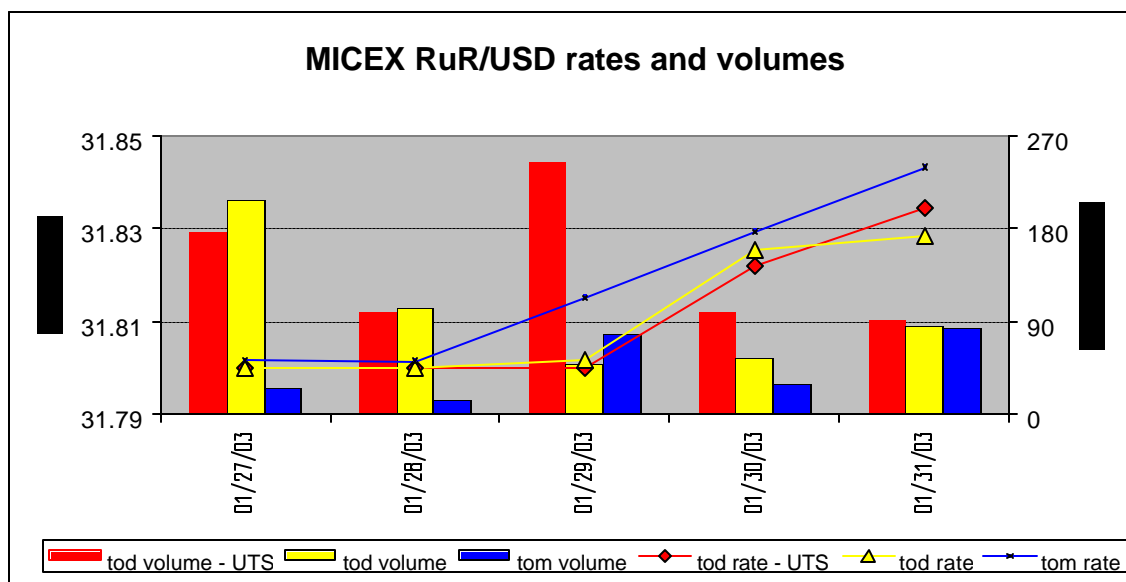
According to Finance Minister Kudrin, Vnesheconombank (VEB), which acquired 94.6% of Roseximbank through the purchase of an additional share issue just three weeks ago, will have to return **Roseximbank** to the GOR. "The main task is to determine the ultimate status of VEB, its charter and functions. This will be done in the course of 2003," Kudrin said on January 28. He added that VEB would not survive as a commercial bank, but will perform certain agency functions for the GOR while its stake in Roseximbank will go back to the GOR. Two days later Vadim Zingman, in charge of export support department in the Ministry for Economic Development and Trade, said that the function of Russia's export agency should be assigned to Roseximbank, whose charter capital should be increased to tens of million dollars by means of another additional share issue. In the 2004 budget, \$50 million, "a figure already coordinated with MinFin," will be allocated for export guarantees, Zingman added. The situation illustrates that there is not yet consensus within the government as to the future role of VEB.

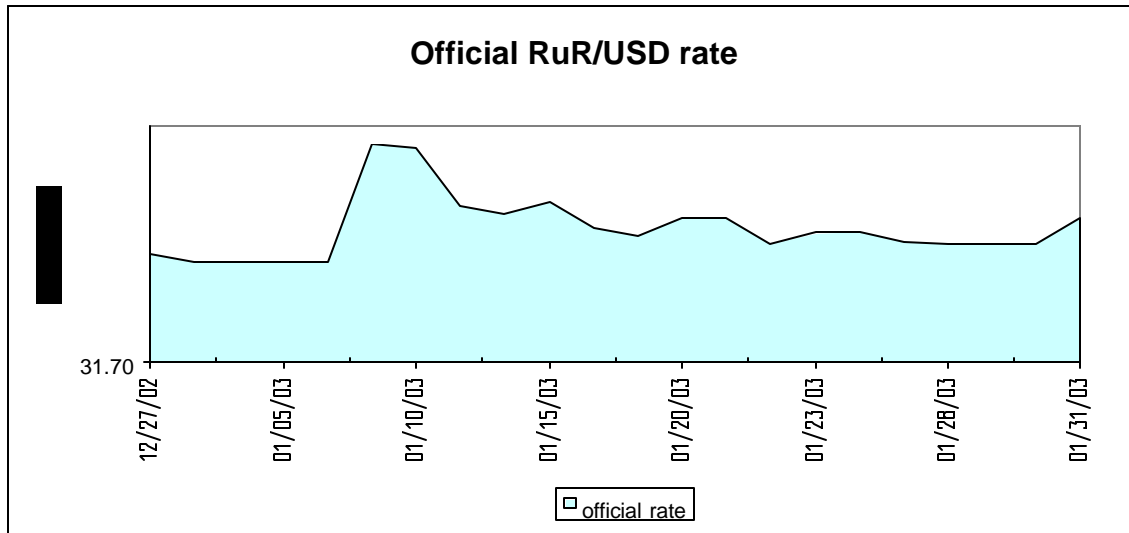
Vneshtorgbank (VTB) has reduced its share in the capital of East-West United Bank (Luxembourg) from 58% to 53%. According to Vladimir Dmitriev, VTB Deputy Chairman, the stake was sold to AFK Systema financial industrial group, which increased its stake, as a result, to 30%. 15% in East-West United Bank belongs to the CBR and the remaining 2% to Eurobank (Paris). This action could be part of the larger trend of government and CBR divestiture of their holdings in foreign daughter banks.

Financial markets**Forex Market**

During the first two days of the week the ruble/dollar rates remained unprecedentedly stable, moving not more than 1 point (1/1000-th of ruble) from Monday to Tuesday in each of the 3 MICEX sessions, due only to the CBR, which kept buying dollars at R31.80/\$. But on Wednesday afternoon the CBR shifted its buy rate to R31.81/\$ after which, in an environment of increasing balances in correspondent accounts with the CBR, the ruble started slowly but steadily weakening. Trade volumes were moderate, with the CBR purchases (for the week it bought \$300-500 million) accounting for the most significant part.

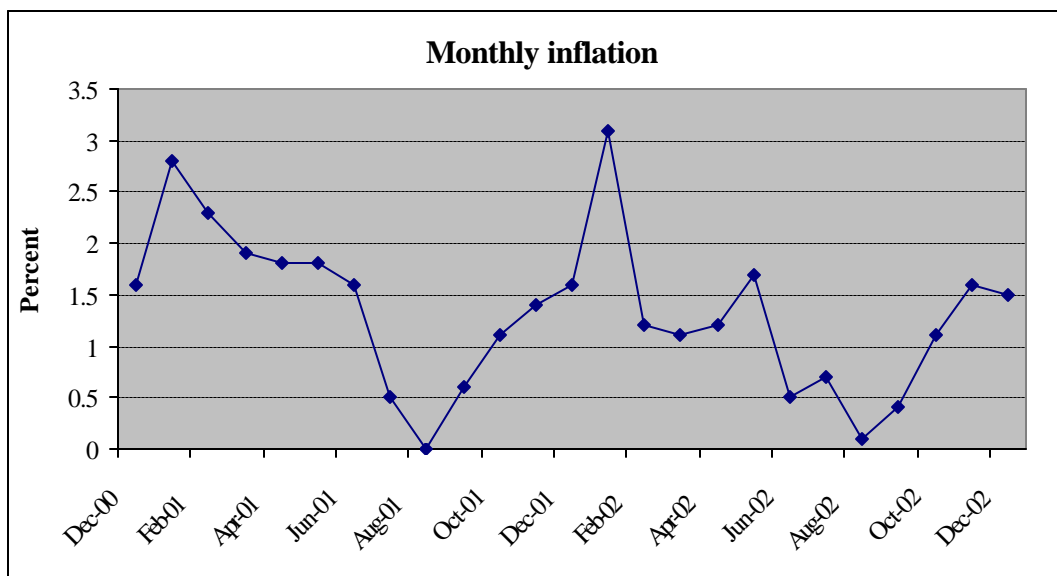
For the week the ruble firmed 0.07% against the dollar, closing in the UTS on Friday at R31.8345/\$. MICEX weekly trade volumes were \$714.22 million, \$502.47 million and \$233.90 million for the morning (UTS), afternoon "tod" and "tom" sessions, respectively.





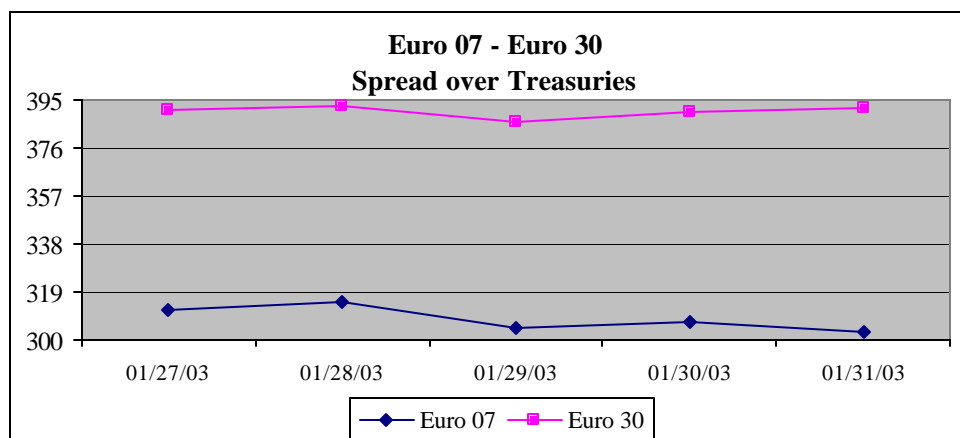
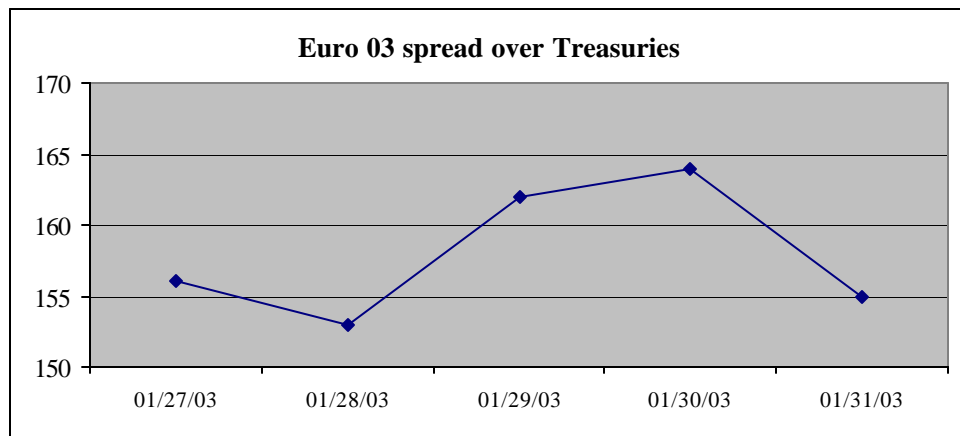
Prices

According to Deputy Prime Minister Aleksei Kudrin, January inflation will most probably be slightly higher than 2%, but lower than in January of 2002, when prices increased by 3.1%. The 2003 target for annual inflation is set at 10-12%. Inflation in Russia experiences a seasonal trend at the beginning of the year, prices for the fruits and vegetables increase and tariffs and excise taxes (gas, tobacco, and alcohol) go up as well.

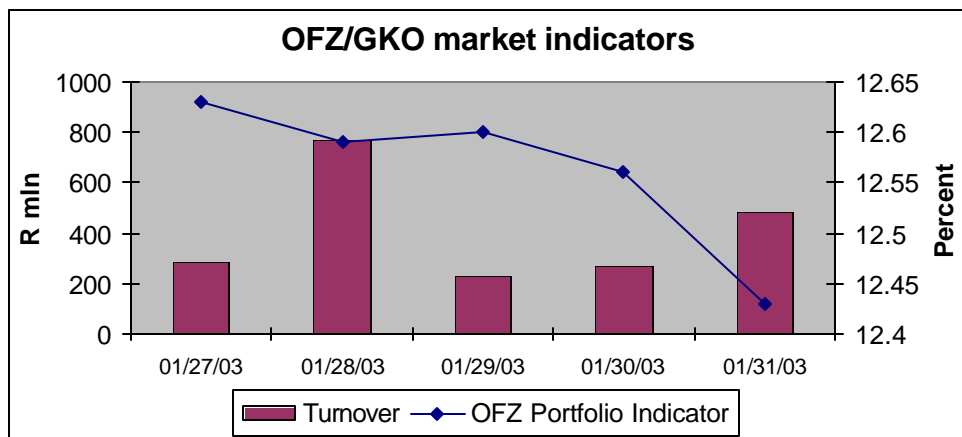


Eurobonds

The Russian Eurobond market fluctuated without any clear-cut trend last week. The price of the Euro-30, the most liquid security in the market, increased from 72.5% of par in the beginning of September to 82.75% in the middle of January. In recent days, however, the growth stopped and some traders believe that the upward movement is almost over unless some good news stimulates the market further. Meanwhile, the Iraq situation is somewhat depressing the market.

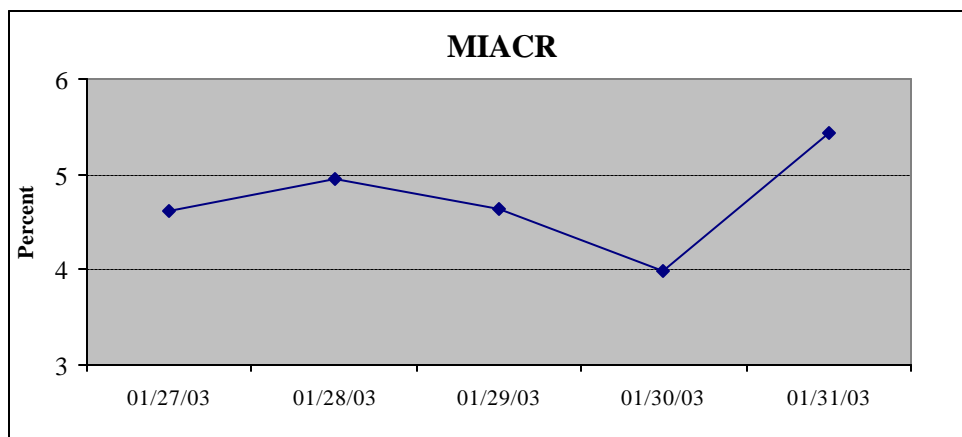
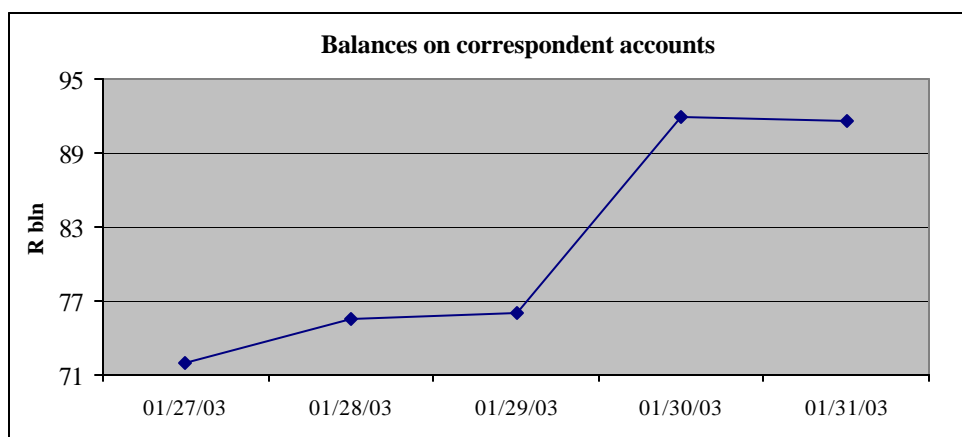
Interest/Bond Market*Bonds/Bills*

The secondary OFZ/GKO market was affected by a ruble shortage on Tuesday, which led the banks to scramble for rubles and redeem OFZ notes, as is the normal pattern mid-month. On Wednesday, liquidity seemed to return to normal levels, as MinFin sold almost all of its R4.94 billion in OFZ papers offered at 12.79%, which mature in April 2005. However, it sold only half of a longer-term issue of R10 billion (maturing in September 2008), at an average yield of 13.34%. These sales helped yields to fall later in the week, as expected.



Overnight rates

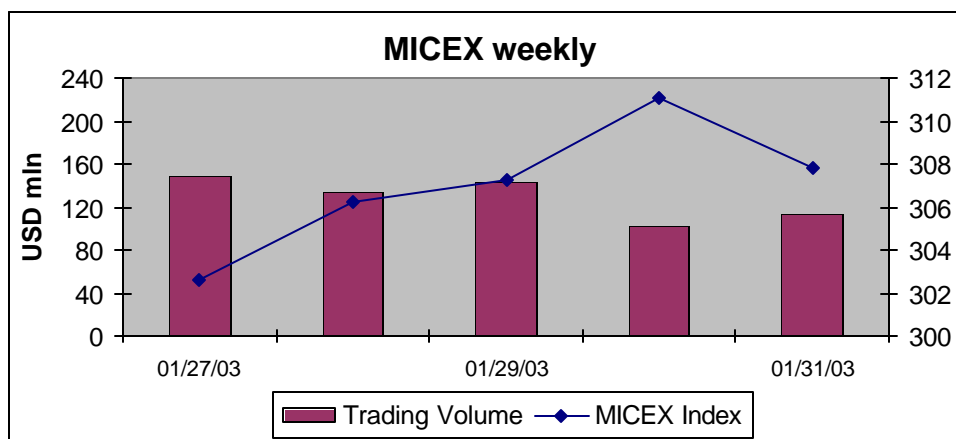
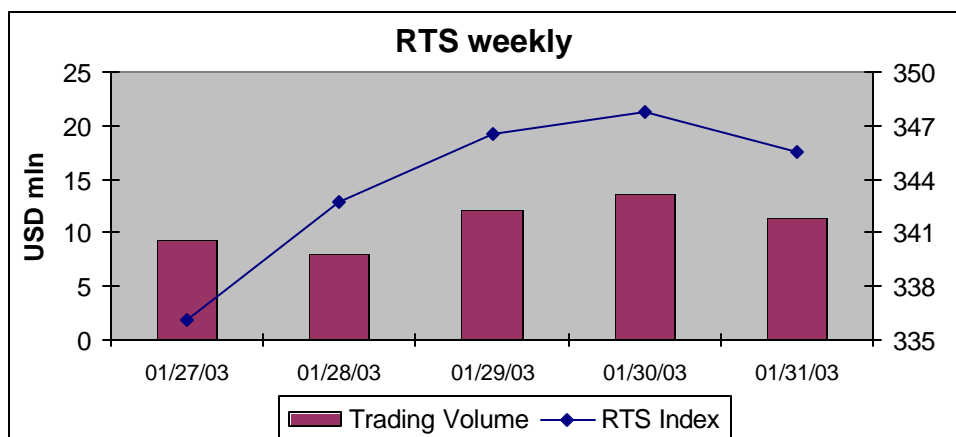
There were no significant shortages of rubles last week. Balances on banks' correspondent accounts at the CBR increased continuously throughout the week, only dropping insignificantly on Friday, ending the week on a higher than average level of R91.5 billion. Overnight rates were 3-6% on average during the week.



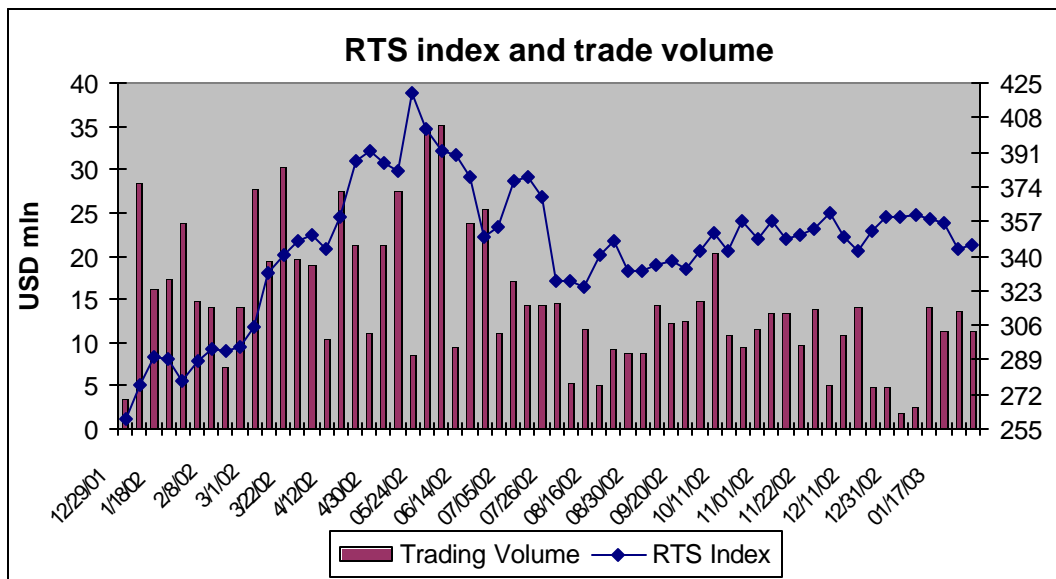
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Stock Market

The Russian stock market opened considerably down (-2.11%) on Monday when the market was waiting for the theme of President Bush's State of the Union address. Uncertainty over Iraq commanded the attention of market participants. Another factor concerning market players is the continuation of the UES reform debate in the Duma. After a drop at the beginning of the week, the RTS grew continuously in the next three sessions, supported mainly by good news from external markets. Expectations of high dividends helped Mosenergo shares grow by 5.23% and RAO UES preferreds - by 4.6% on Thursday. During the last trade session of the week, the stock market changed direction several times and was down by 0.63% for the day. Traders characterized the situation as "cautious optimism". The good news is that RTS index was able to consolidate above 340 level, which served as a serious support level for several months. The RTS index increased by 0.66% for the week in dollar terms. However, it is still 3.76% lower than it was at the beginning of the year.

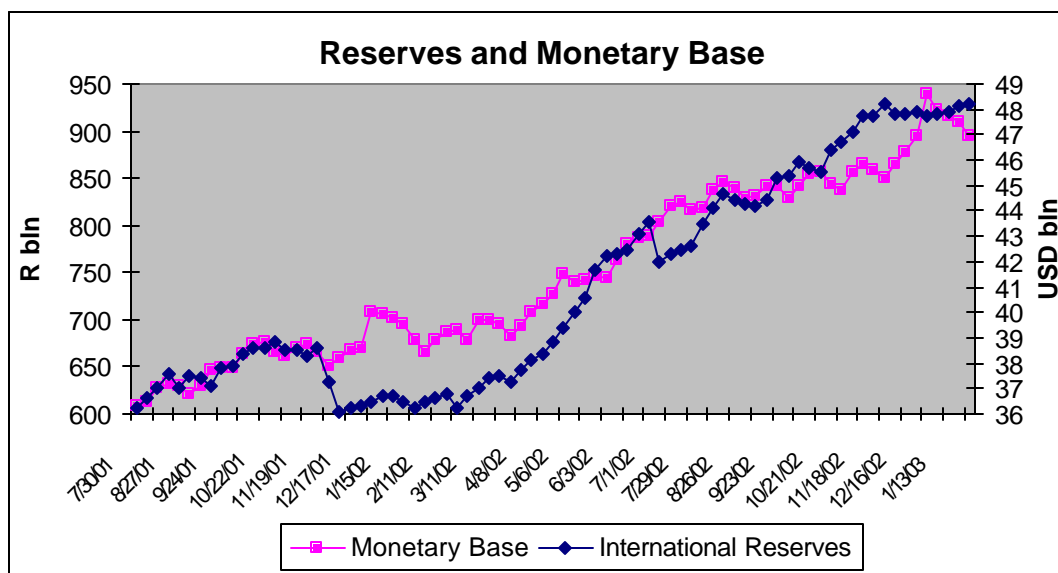


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International Reserves and Monetary Base

The international reserves of the CBR grew for the fourth week in a row and reached \$48.2 billion during the week of January 24, \$100 million higher than the week before. According to the first Deputy Chairman of the CBR, foreign exchange reserves might total \$55 billion by the end of the year, which would represent a 15.3% annual increase. The actual increase could be even higher, allowing for the usual conservatism of CBR officials. The monetary base fell considerably, by R15.5 billion, back to its December before the seasonal increase. It has already dropped by R46 billion since the beginning of the year and was at R894.3 billion as of January 27.



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EXPLANATORY NOTES

1. EXCHANGE RATES: SELT - "System of Electronic Lot (currency) trading" -- a computer based OTC-style trading system organized by the Moscow Interbank Currency Exchange (MICEX). MICEX Unified Trading Session (UTS) is the one in which exporters have to sell 50% of the repatriated currency. UTS fix (rounded) becomes the "official" ruble rate for the next day. "\$-tod" price is the price of the dollar with same day delivery. "\$-tom" is the price of the dollar with delivery on the next day. Minimum lot size for each of the dollar instruments is \$100,000. Average price is quoted as the weighted average of all actual deals entered into the system by various banks.

2. INTEREST RATES: Moscow InterBank Actual Credit Rate is calculated as the average-weighted rate on the volume of actual transactions in interbank loans by commercial banks.

3. STOCK INDICES: The RTS index is the only official indicator of the Russian Trading System. It is calculated every 30 minutes of the RTS trade session, starting at 12:00. It comprises 60 shares of 35 leading companies. These shares are included in so-called Category "A" listings. The index indicates over-the-counter stock prices. The index represents the ratio of the total market capitalization of the shares of the companies selected for the index to the total market capitalization of the same shares as of the initial date multiplied by the index value as of the initial date (31 December 1997) using a base of 100 beginning September 1, 1995. The ruble-adjusted index is a derivative of the main dollar index, using the same base. The MICEX index is calculated by the stock section of the Moscow Interbank Currency Exchange and is based on the price fluctuations of 17 shares of the MICEX's first and second listings.

4. INTERNATIONAL RESERVES OF THE RUSSIAN FEDERATION represent the amount of reserve assets of the Bank of Russia and Finance Ministry. Those reserve assets are comprised of monetary gold, special drawing rights, the reserve position in the IMF and other liquid foreign assets. The latter include short-term deposits in non-resident and resident banks, balances in current accounts, foreign government securities, repo agreements with these securities made with non-residents, and other liquid assets (accrued interest on these assets is not included). Monetary gold is evaluated at a floating rate, revised periodically, but not always reported immediately. Foreign currency assets are converted into U.S. dollars on the basis of the cross rates of foreign currencies to the dollar, calculated using the official rates of the ruble to these foreign currencies, as set by the CBR.

5. MONETARY BASE (M1) is comprised of cash and reserves of commercial banks on deposit in the CBR. It is the basic part of the money supply (M2).

6. LOMBARD CREDITS, distributed through auctions, are aimed to provide liquidity to the banking sector. These credits are extended to banks on the basis of collateral.

